IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-750

LIBERTY NATIONAL LIFE INSURANCE COMPANY,
Petitioner,

VS.

UNITED STATES OF AMERICA,
Respondent.

On Petition For a Writ of Certiorari to the United States Court of Appeals For the Fifth Circuit

PETITIONER'S REPLY TO MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioner desires to reply to three arguments of the Government first raised in its Memorandum in Opposition.

A.

TAXPAYER'S TREATMENT OF DISCOUNTS IN THE NATURE OF INTEREST IN COMPUTING ITS INCOME TAX LIABILITY WAS NOT A "DOUBLE-DEDUCTION."

There is at least an implication in the Government's brief that Liberty National has claimed a double deduction for the discounts granted on weekly or monthly premiums paid on life insurance policies in advance of their due date. It reads "Peti-

tioner treated the aggregate amounts of the 'discounts' *not only* as offsets against gross premium income in the computation of its gain from operations under Section 809 of the Code, *but also* as discounts in the nature of interest on advance premiums to be offset against investment income in the computation of its 'taxable investment income' pursuant to Section 805 (e) (3) of the Code." (Op. Mem. 2) The law clearly permits discounts in the nature of interest to be treated as Liberty National did in its determination of taxable investment income. See I.R.C. Section 805 (e) (3). The question of an implied double deduction then revolves around whether or not Liberty National was entitled to deduct such discounts in determining its "gain from operations."

The confusion apparently stems from the prohibition in Section 809 (e) (1) which prohibits a deduction for interest in respect of items described in Section 810 (c). Section 810 (c) includes the liabilities (or reserves) for life insurance, unearned premiums, supplementary contracts, dividend accumulations, premiums received in advance, and liabilities for premium deposit funds, etc. This is necessary where there are reserves or deposits or where the advance premium liabilities are increased by interest during the year since the interest thereon will be a deduction in the item of reserve increase. In the discount involved in the instant case, however, Taxpayer does not increase its liability for advance premiums for an interest factor in establishing it. It is thus entitled to such deduction elsewhere. *All* interest which is used in determining "taxable investment income" is similarly deducted in determining "gain from operations" whether as a portion of reserve increase, included in benefits paid, as a direct deduction for interest paid, or elsewhere. Liberty National did not include such discounts as a portion of reserve increase and, therefore, is entitled to a deduction elsewhere in computing its gain from operations. To attempt to obscure the issue by charging "double deduction" detracts from the merited consideration of the issue.

It should also be pointed out that nowhere in the Government's arguments or briefs before either the District Court or the Fifth Circuit or in its audit of Liberty National's return was there any claim that Liberty National had in fact benefited from a double deduction, and this Court should not be influenced by this erroneous implication.

B.

PETITIONER DID NOT TAKE AN "ALL-OR-NOTHING" APPROACH.

The Government insists that the Court below was correct in finding that Petitioner had taken an "all-or nothing" approach. (Pet. App. B. A-48; Op. Mem. 3) In its Petition (page 6), Taxpayer pointed out that in filing its income tax returns initially for the years 1966 and 1967, Taxpayer claimed only 60 percent of the total discount as being in the "nature of interest" within the meaning of Section 805 (e) (3). Some two or three years after these returns were filed, they were audited by the Internal Revenue Service and a written report was completed. This report of the I.R.S. took the position that, ". . . the discounts allowed for advance premium payments . . . was allowable as interest or an item in the nature of interest for 100 percent of the discount." (Pet. 6)

This holding of the I.R.S. on audit was to the benefit of the Taxpayer which then took the position which the I.R.S. on audit asserted, that is, that the entire amount of the discount (not just 60 percent thereof) was discount "in the nature of interest." Claims for refund were filed on this basis. The claims were denied. Suit was filed claiming the entire amount as being in the nature of interest, and the District Court agreed that the entire discount was in the nature of interest within Section 805 (e) (3). (Pet. 6-7)

Thus, it is true that in the claim for refund, in the suit for refund, and in argument on appeal before the Fifth Circuit, Peti-

tioner took the position that the entire amount of the discount was in the nature of interest. But initially and for years prior to those involved in this suit, Taxpayer had claimed only 60 percent of the discount as being in the nature of interest. Thus, contrary to the assertion of the Government in its Memorandum in Opposition, it was not Taxpayer which initially took the "all-or-nothing" approach. That approach was initially asserted by the Government's own auditor. These circumstances argue very heavily in favor of the remand insisted upon by Petitioner so that the proper portion of the discount which is in the "nature of interest" might be determined.'

Finally, the "all-or-nothing" approach which the Court of Appeals and the Government would relegate Petitioner to is contrary to the provisions of Rule 54(c) of the Federal Rules of Civil Procedure which provides in part that, ". . . every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings." Under this rule it has been said, "the question is not whether plaintiff has asked for the proper remedy but whether he is entitled to any remedy." 10 Wright & Miller, *Federal Practice and Procedure: Civil* Section 2664, Pages 108-109. The Fifth Circuit said, ". . . .we are in no doubt that plaintiff is entitled to the relief to which the proven facts entitle him, even though his own legal theory of relief may have been unsound." *Hutches* v. *Renfroe* (5 Cir. 1952) 200 F. 2d 337, 340.

C.

THE DECISION OF THE COURT OF APPEALS FOR THE FOURTH CIRCUIT IN *LIBERTY LIFE INSURANCE CO.* V. *UNITED STATES*, 594 F.2d 21 (4 Cir. 1979), cert. den. No. 78-7825 (October 1, 1979) IS NOT CONTROLLING AND IS FACTUALLY DISTINGUISHABLE.

Reliance by the Government for support from this decision, (Op. Mem. 3 et seq.) is misplaced. A statement of the issues as framed by the two courts in the respective opinions reflects the distinction.[1] In the instant case the trial court stated the issue to be:

> "Were certain discounts for advance payments of weekly insurance premiums properly deducted as 'discounts in the nature of interest' within the meaning of Section 805 (e) (3) of the Internal Revenue Code?" (Pet. App. A-1)

In *Liberty Life* the issue was stated to be:

> ". . . whether a discount plaintiff grants to savings and loan associations for yearly payment of a mortgage cancellation insurance premium is a 'discount in the nature of interest' within the meaning of 26 U.S.C. Section 805 (e) (3)." (594 F.2d 21, 22)

A brief analysis of *Liberty Life* will reflect the distinction. Involved there were decreasing level term life insurance policies on the lives of borrowers from savings and loan associations. These

[1]Incidentally, it should be pointed out that though the names of the taxpayers in the two suits are similar, viz.: Liberty National Life Insurance Company, Petitioner in these proceedings, and Liberty Life Insurance Company, plaintiff in the cited case, they are separate organizations and separate companies and have not the same ownership. There is no connection between them.

policies were designed to pay the balance of a borrower's indebtedness to the association in the event of death of the borrower prior to full payment of the debt. The savings and loan association was the beneficiary. But it was also the selling agent, and it collected the premiums on the insurance policies along with the installment payments on its debt from premium payer who was also the borrower. Initially, the savings and loan association remitted the premiums to the insurance company monthly as they were collected. Later the insurance company agreed to accept an annual payment in advance from the savings and loan association in an amount less than the total of the monthly payments. The savings and loan association, however, continued to collect the full monthly premiums from the policyholders (borrowers). The Court there found that the annual payment for the mortgage life insurance was a "mode" of payment and that the lesser amount paid was the result of expense savings. It then pointed out that the discount was not in the nature of interest, and that it went to the beneficiary savings and loan association rather than the premium payer policyholder. It concluded that the amounts in question were, "neither prepaid premiums nor discounts in the nature of interest."

These facts are significantly different from the facts and conclusions involved in this appeal. In *Liberty Life,* as the Court pointed out, the policyholders paid their full nondiscounted premiums monthly as they became due. It was not the policyholders who paid a lesser amount on their premiums to the insurance company. It was the premium collector. So the Court concluded that the payments were not premiums paid in advance. The premiums paid by the insureds were not paid in advance but monthly as they became due. It was the third party, the beneficiary who received the benefit by paying a reduced annual amount to the insurance company which was accepted as payment for the premiums. The beneficiary received the larger, aggregate twelve monthly premiums from the insureds for serving as a collection agency.

The Fourth Circuit explained in more detail the factual background in *Liberty Life* (594 F.2d 21, 26-27):

> "In 1922 Liberty Life developed a system of mortgage cancellation life insurance. This system was designed to pay off a mortgagor's outstanding home mortgage balance in the event of his death prior to the mortgage termination. The insurance is marketed through mortgagee institutions, primarily savings and loan associations. Liberty Life bills these associations for the mortgage cancellation premiums; the associations in turn collect the premiums from the policyholders, who generally remit the premiums in monthly installments as part of their regular mortgage payments. The associations receive a commission for the sale and collection of the mortgage cancellation insurance.
>
> Until 1946 the associations remitted the mortgage cancellation premiums monthly to Liberty Life, but in that year the company began offering the associations the option of remitting the 12 monthly premiums in advance for each year or paying a single annual lump sum at a 3 percent front-end discount. Since then, the company has expanded and diversified this option, so that for the taxable year 1965 the discounts granted ranged from 3.65 to 7.25 percent. It is these discounts which are at issue here."

The Court itself then stated expressly that the *Liberty Life* case was "distinguishable on its facts" from the Liberty National decision, pointing out some distinguishing facts. (594 F.2d 21, 29-30)

CONCLUSION

In its petition, Taxpayer presented two questions for review by this Court. It insists that it was not "just under the circumstances" for the Court of Appeals to reverse without remanding the case to the trial court for redetermination of the amount of refund due. It insists that in substituting its view of the evidence for that of the trial court, the Court of Appeals departed from the "accepted and usual course of judicial proceedings. "Wherefore, Petitioner respectfully prays this Court to issue its writ to the Court of Appeals for the Fifth Circuit to review its opinion and judgment.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Pursuant to Supreme Court Rule 33, I hereby certify that all parties required to be served have been served as follows: three copies to this Reply have been air mailed to the Solicitor General, Department of Justice, Washington, D.C. 20530, and three copies have been air mailed to Mr. M. Carr Ferguson, Assistant Attorney General, Tax Division, Department of Justice, Washington, D.C. 20530, on this 23rd day of January, 1980.

Attorneys for Petitioner